Supreme Court, U. S.
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IN THE

Supreme Court of the United States

OCTOBER TERM, 1976

No. 76-632

LORD, BISSELL & BROOK, MAX E. MEYER and LOUIS F. SCHAUER,
Petitioners

v.

SECURITIES AND EXCHANGE COMMISSION,
Respondent

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE DISTRICT OF COLUMBIA CIRCUIT

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PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE DISTRICT OF COLUMBIA CIRCUIT

Petitioners request that a writ of certiorari issue to review the judgment of the United States Court of Appeals for the District of Columbia Circuit affirming a decision striking an affirmative defense asserted by petitioners. The affirmative defense, if allowed, would be dispositive of this litigation insofar as petitioners are concerned.

OPINION BELOW

The opinion of the Court of Appeals, which is unreported, is set forth in Appendix "A".

JURISDICTION

The opinion of the Court of Appeals, Judge McGowan dissenting, was filed on May 17, 1976. The Petition for Rehearing and Suggestion for Rehearing *En Banc* was

denied by the Court of Appeals on August 11, 1976, Chief Judge Bazelon and Judge McGowan voting for rehearing. The jurisdiction of this Court is invoked under 28 U.S.C. § 1254(1).

CONSTITUTIONAL PROVISION AND REGULATION INVOLVED

(1) The Fifth Amendment of the United States Constitution.

(2) A Securities and Exchange Commission directive promulgated on September 1, 1970. A copy of that directive is attached hereto as Appendix "B".

QUESTIONS PRESENTED

1. Whether the SEC was required by the Due Process Clause of the Fifth Amendment and an SEC directive to inform petitioners prior to the commencement of this action that they were targets of an SEC investigation, and to afford them an opportunity to present their contentions as to why they should not be sued by the Commission.

2. Whether the Court below, in holding that the SEC directive was discretionary rather than binding on the SEC staff, improperly relied on information not disclosed to petitioners and improperly precluded petitioners from conducting discovery relating to the directive.

STATEMENT OF THE CASE

Petitioners Lord, Bissell & Brook, Max E. Meyer and Louis F. Schauer hereby adopt and incorporate by reference the Petition for Writ of Certiorari to the United States Court of Appeals for the District of Columbia Circuit, No. 76-568, filed by Petitioners White & Case and Marion J. Epley, III, on October 22, 1976. That

petition accurately sets forth both the proceedings below and the reasons supporting the granting of a Writ.

Petitioners are Lord, Bissell & Brook, a prominent Chicago law firm and two of its senior partners, Max E. Meyer and Louis F. Schauer (hereinafter collectively referred to as "LBB"). In 1969 LBB was retained by Interstate National Corporation ("Interstate"), a publicly-held Chicago-based insurance company, to provide legal assistance in connection with Interstate's proposed merger with the National Student Marketing Corporation ("NSMC"), a publicly-held District of Columbia corporation. Interstate was one of twenty-five companies acquired by NSMC during its spectacular rise to Wall Street prominence between 1968 and 1970.

On the day of the Interstate-NSMC merger closing, October 31, 1969, certain financial information relating to NSMC was provided to Interstate in the form of a comfort letter from NSMC's accountants, Peat, Marwick & Mitchell, pursuant to the merger agreement. Based on the information contained in that comfort letter, the SEC contends that LBB, and other attorneys, violated the antifraud provisions of the federal securities laws by failing to insist that NSMC's financial statements be revised and that shareholders be resolicited, and failing that, to cease representing their respective clients and notify the Commission. These contentions are not only unprecedented,[1] but in apparent conflict with an attorney's ethical obligations under the American Bar Association's *Code of Professional Responsibility*.[2]

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[1] *See e.g.*, Lowenfels, *Expanding Public Responsibilities of Securities Lawyers: An Analysis of the New Trend in Standard of Care and Priorities of Duties*, 74 Colum. L. Rev. 412, 421 (1974).

[2] American Bar Association, *Code of Professional Responsibility*, Disciplinary Rule 7-102. *See* American Bar Association, Report of the Committee on Counsel Responsibility and Liability, 30 BUS. LAW. 1289, 1300-1301 (1975).

A private investigation into whether NSMC, its officers or directors had violated federal securities laws was authorized by the SEC on February 24, 1970. In connection with the investigation, the SEC requested that Petitioner Schauer testify with respect to the "NSMC matter."[3] On December 9, 1971, Mr. Schauer traveled to Washington to assist the SEC in its investigation and to provide testimony concerning the merger. Petitioner Meyer, the other LBB partner involved in the merger, accompanied Mr. Schauer to assist the SEC also and to be available in the event the SEC had additional questions concerning the transaction. At no time was either individaul aware or informed that he was himself a target of the SEC investigation, although the SEC staff had been actively considering suit against LBB at least as early as March 26, 1971.[4] To the contrary, petitioners were shown an order of investigation by the SEC staff which named only NSMC, its officers and directors as targets. Similarly when Louis F. Schauer appeared as legal counsel for Cameron A. Brown, former president of Interstate, during Mr. Brown's SEC deposition, no indication was given that either individual was under consideration as a potential defendant.

If petitioners had been advised that they were potential defendants in an enforcement proceeding, as required

[3] A copy of the affidavit filed by Louis F. Schauer in the District Court on September 16, 1974, which sets forth the SEC staff's representations to him during the SEC investigation, is attached hereto as Appendix "C".

[4] SEC Memorandum of Law to Richard H. Rowe from Alois Lubiejewski, Re: Possible Violations of the Securities Laws by John Glandon Davies, director and house counsel of NSMC; White & Case, counsel for NSMC; Peat, Marwick, Mitchell & Co., Certified Public Accountants, and Lord, Bissell & Brook, counsel for Interstate National Corporation, dated March 26, 1971.

by the September 1, 1970 SEC directive to its staff,[5] they would have had the opportunity to retain outside counsel in connection with their own appearances before the SEC, to cease representing any client having a potential conflict of interest, as required under the *Code of Professional Responsibility*,[6] and to submit their contentions to the Commission as to why they should not be sued.

The significance of the SEC's failure to abide by its own directive, and accord LBB the same rights and privileges granted to other defendants similarly situated, is best demonstrated by a comparison between the SEC investigation and the conclusions reached by the Department of Justice. After an investigation of the NSMC fraud which included the events which took place during the Interstate-NSMC closing, the Department of Justice repeatedly asserted, in connection with the subsequent criminal proceedings against various NSMC officers and

[5] The September 1, 1970 directive provides in pertinent part:

> The Commission has determined that the staff should adopt the following procedures in presenting its recommendations for enforcement actions to the Commission.
>
> * * * *
>
> (2) If the probable defendants to a proposed injunctive action wish to discuss consents with the staff *prior to the time the Commission authorizes the action, the staff should afford the parties involved an opportunity to present their proposals and arguments.*
>
> * * * *
>
> In regard to . . . injunctive actions, the Commission requests that the staff's memoranda to the Commission recommending the particular action *set forth separately any arguments or contentions as to either the facts or the law involved in the case which have been advanced by the prospective respondents and which countervail those made by the staff in its memoranda as a basis for the recommendation.* [Appendix "B"] (Emphasis added).

[6] DR 5-102(A), ABA *Code of Professional Responsibility.*

outside accountants,[7] its conclusions that LBB and Interstate were the innocent victims of a fraud perpetuated by NSMC,[8] and that neither LBB nor Interstate were provided with information necessary to permit them to know that the financial data presented at the merger closing were the product of fraud.[9] Furthermore, the government concluded that the comfort letter given to LBB at the closing did not reveal the true financial status of NSMC nor provide sufficient information "in context" to deter the Interstate merger.[10] If LBB had been accorded the same opportunity to present information to the SEC prior to the commencement of this action, that it had to present information to the U. S. Attorney, there is a substantial likelihood that LBB would not have been named in this proceeding, and that a wrongful and needless attack on the otherwise unblemished reputation of these distinguished attorneys would have been avoided.

REASONS FOR GRANTING THE WRIT

Petitioners are in full agreement with and adopt and incorporate herein the reasons for granting writ set forth in the Petition for Writ of Certiorari, No. 76-568, filed by petitioners White & Case and Marion J. Epley, III on October 22, 1976.

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[7] *United States* v. *Natelli and Scansaroli*, 74 Cr. 43 (1974), S.D.N.Y., 1974. *United States* v. *Davies*, 74 Cr. 985 (1974), S.D.N.Y., 1974.

[8] *See, e.g., Natelli* Trial Transcript, at 31, 36, 48, 52-53, 55-58, 60-61, 64-65, 2267-69, 2270.

[9] *See, e.g., Davies* Trial Transcript, at 19-21, 23, 24, 33, 38-39; *Natelli* Trial Transcript, at 36, 48, 52-53.

[10] *See, e.g., Natelli* Trial Transcript, at 57-58, 60-61.

CONCLUSION

For those reasons, a writ of certiorari should be granted.

Respectfully submitted,

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Max E. Meyer and
Louis F. Schauer

Dated: November 3, 1976

APPENDICES

APPENDIX A

UNITED STATES COURT OF APPEALS
FOR THE DISTRICT OF COLUMBIA CIRCUIT

No. 75-1700

SECURITIES AND EXCHANGE COMMISSION,

—v.—

NATIONAL STUDENT MARKETING CORPORATION, *et al.*,
WHITE AND CASE and MARION JAY EPLEY, III,
Appellants.

No. 75-1701

SECURITIES AND EXCHANGE COMMISSION,

—v.—

NATIONAL STUDENT MARKETING CORPORATION, *et al.*,
LORD, BISSEL, BROOK, MEYER and SCHAUER,
Appellants.

No. 75-1702

SECURITIES AND EXCHANGE COMMISSION,

—v.—

NATIONAL STUDENT MARKETING CORPORATION, *et al.*,
ANTHONY M. NATELLI & JOSEPH SCANSAROLI,
Appellants.

Appeals from the United States District Court
for the District of Columbia
(Civil 225-72)

Argued December 6, 1975
Decided May 17, 1976

Daniel A. Rezneck, with whom *Milton J. Freeman*, *Abe Krash* and *Lawrence A. Schneider* were on the brief, for appellants in No. 75-1700. *Steven M. Schatz* also entered an appearance for appellants in No. 75-1700.

James A. Hourihan, with whom *Sherwin J. Markman*, *Martin Michaelson* and *Dennis J. Whittlessey* were on the brief, for appellants in No. 75-1701.

Mathias E. Mone, with whom *William E. Hegarty* was on the brief, for appellants in No. 75-1702.

David Ferber, Solicitor, Securities and Exchange Commission, with whom *Frederic T. Spindel;* Assistant General Counsel and *Lawrence A. Horn*, Attorney, Securities and Exchange Commission, were on the brief, for appellee. *Van P. Carter*, Attorney, Securities and Exchange Commission, also entered an appearance for appellee.

Before McGOWAN, TAMM and ROBB, *Circuit Judges.*

Opinion *per curiam.*

Dissenting opinion filed by *Circiut Judge* McGOWAN.

Per Curiam: This appeal concerns an affirmative defense asserted in the answer of appellants White & Case and Epley as their Fifteenth Defense to a complaint by the Securities and Exchange Commission. That defense alleges:

> [T]he Securities and Exchange Commission violated its own rules, procedures, and directives and the United States Constitution by instituting this action without informing . . . [appellants] that they were "prospective defendants or targets" of the Commission investigation prior to the institution of the suit, and without affording . . . [appellants] or their counsel an opportunity to present their contentions to the Commission or the Commission staff as to why they should not be sued.

Amended Answer of Defendants White & Case and Marion Jay Epley, III, to the first Amended Complaint, April 9, 1973, ¶ 50; J.A. at 105.

The Commission moved to strike the Fifteenth Defense as legally insufficient. In response, appellants pointed to an internal, non-public memorandum of September 1, 1970, from the Commission to its senior staff, by which

> the Commission request[ed] that the staff memoranda to the Commission recommending the particular action set forth separately any arguments or contentions as to either the facts or the law involved in the case which have been advanced by the prospective respondents and which countervail those made by the staff in its memoranda as a basis for the recommendation.

SEC Memorandum to All Division Directors and Office Heads, Re: Procedures Followed in the Institution of Enforcement Proceedings, September 1, 1970; J.A. 1-3. Appellants assert that this language embodies the directive which the Fifteenth Defense alleges the staff to have violated, and that the staff's departure from this procedure constitutes grounds for dismissal of this action.

The district court struck the Fifteenth Defense as legally insufficient, holding that the 1970 Memorandum was not designed for protection of prospective defendants' rights, but later vacated its decision and reinstated the Fifteenth Defense without prejudice to the Commission to renew its motion to strike. The latter order was based on the court's determination to ensure that no evidence relevant to the Commission's intent to issuing the 1970 Memorandum had been overlooked in the earlier ruling.

Appellants then requested production of various documents including memoranda prepared by individual Commissioners and agency staff members. The Commission responded by producing the only document issued by the

Commission itself that referred to the 1970 Memorandum and related to the circumstances of its issuance, a minute of the Commission approving issuance of the 1970 Memorandum and dissemination to the staff. The Commission moved for a protective order respecting 67 other internal Commission documents that fell within the scope of the request and submitted the documents to the court for *in camera* inspection. The Commission contended that these internal documents were protected from disclosure by the intragovernmental privilege and that, in any case, none was relevant to the intent, reason or purpose of the Commission in issuing the 1970 Memorandum. At the same time, the Commission renewed its motion to strike the Fifteenth Defense on March 18, 1975. The district court granted the Commission's motions, concluding that none of the documents contained interpretive material or tended to support petitioners' claim that the 1970 Memorandum constituted a procedural directive or that non-compliance with the discretionary procedure could be a basis for dismissal. This appeal followed.

We affirm the order of the district court, satisfied that the court was correct in concluding that the Commission documents are "protected from disclosure by reason of the privilege for internal governmental memoranda containing advice or opinions," and that the privilege should not be over-ridden in this instance becasue "none of the requested documents [examined *in camera*] is relevant to the intent behind the 1970 directive." By way of explanation, the court further stated that none of the documents could indicate agency intent, since internal documents authored by agency staff or individual Commissioners "cannot be considered as an official expression of the will and intent of the Commission." The "great bulk of the documents requested . . . are not 'Commission-authored' but rather . . . consist with few exceptions, of memoranda among individaul Commissioners, their legal assistants and Commission staff." Consequently, the court

concluded that such documents could not be relied upon as indicators of agency intent.

At best, the documents indicate that there was a practice of notification, at the discretion of the staff, where such notification would not impede the investigation. There is no indication that the practice was regularly followed or that any such policy was ever established by the Commission. Given the novel nature of this cause, we see no procedural infirmity, Constitutional or statutory, in the decision of the staff not to inform the prospective defendants that they were under investigation or to solicit their arguments as to why they should not be sued. Mandating such a procedure would seriously burden the Commission's enforcement procedure, already characterized by adequate due process safeguards. See 15 U.S.C. § 78u (1970). Had the Commission intended to establish a procedural rule which, if breached, would require dismissal of a complaint, we think it would have said so in language far clearer and more direct than that found in the 1970 Memorandum.

For these reasons, we affirm the action of the District Court in striking the Fifteenth Defense.

MCGOWAN, *Circuit Judge, dissenting*: By reference to what is in the public record of this case, I can conclude only that in 1970 the Commission directed its staff to transmit with all recommendations for the institution of formal proceedings the arguments of the prospective respondents against such action. It is obvious that that policy could not be effectuated without notification being given to persons who were the targets of the staff investigations. That policy, although never publicly revealed, was in effect at the times relevant to this appeal, and on its face does not admit of any exceptions. We know also, however, that in a public release issued in 1972 the Commission characterized the practice it had been following as one permitting persons involved in a

staff investigation, *on their request*, to submit to the Commission statements before staff recommendations for formal proceedings would be acted upon; and in that context the Commission stated the obviously correlative proposition that the staff, "in its discretion, may" take the necessary step of notifying investigation targets of the nature of the violations involved and the time available to them for making a submission to the Commission.

But whether the staff did or did not have discretion at the times here in issue does not seem to me determinative of this appeal. For even if discretion existed *vis-a-vis* the Commission, in relation to those under investigation, problems of procedural fair play swarm around the question of how and why that discretion is exercised in a particular case. That is especially true when, as here, professional advisers of clients under investigation are the unknowing targets. And it is not only the interests of those advisers that are affected adversely but that of the clients themselves. Is it seriously to be supposed that the lawyers here involved, if they had been apprised of their target status, would not have immediately withdrawn as counsel for the clients and, indeed, retained counsel for themselves?

I am not prepared to say that the defense in issue should have been stricken by the district court without more exploration on the record of both the authority and the justifications for the staff's proceeding as it did in this case. That exploration can, in my judgment, best be achieved by directing the reinstatement of the defense in question at the present stage of the litigation, and of ventilating its merits or demerits at trial or, at the least, after further opportunity for discovery as to exactly what the Commission's policy was and the standards by which it was being applied generally as well as in this particular instance. As a start in this direction, the district court should make available to plaintiffs the materials examined by it *in camera.*

APPENDIX B

MEMORANDUM

September 1, 1970

TO: All Division Directors and Office Heads

FROM: The Commission

RE: Procedures Followed in the Institution of Enforcement Proceedings

The Commission has considered the procedures currently followed in the institution of enforcement proceedings, both administrative proceedings and injunctive actions. The Commission has determined that the staff should adopt the following procedures in presenting its recommendations for enforcement actions to the Commission:

In regard to administrative proceedings:

(1) Offers of settlement should not be negotiated prior to the time the staff presents its recommendation for administrative proceedings to the Commission. The staff should present its recommendations to the Commission as soon as possible after concluding its investigation or inquiry in the particular case.

(2) Before proceedings are recommended to the Commission if the probable respondents desire to discuss settlement with the staff prior to the conclusion of the staff's investigation or inquiry, the staff should afford the parties involved an opportunity to present their proposals and arguments. The staff may, of course, discuss the facts of the case with the parties and may indicate to them the nature of the violations which the staff believes have occurred. The staff should not, however, institute or suggest discussions of settlement or negotiate terms

of settlement or indicate the particular recommendation the staff intends to make to the Commission, prior to the time the recommendation is submitted to the Commission.

(3) Where the statute allows, the Commission will ordinarily authorize private proceedings in order to avoid unnecessary publicity and to afford respondents in administrative proceedings time to discuss settlement with the staff after the proceedings are authorized, except in those cases that involve a need to alert public investors to continuing practices or acts which would operate as a fraud on such investors.

(4) After administrative proceedings have been authorized by the Commission, if a settlement is not reached in a reasonably short period of time, the case should proceed forthwith to a hearing.

In regard to injunctive actions:

(1) The staff should not negotiate the consents to proposed injunctive actions prior to the time the Commission has authorized the bringing of the action. Recommendations for injunctive action should be presented to the Commission as soon as possible after the staff has concluded its investigation or inquiry in the particular case.

(2) If the probable defendants to a proposed injunctive action wish to discuss consents with the staff prior to the time the Commission authorizes the action, the staff should afford the parties involved an opportunity to present their proposals and arguments. The staff may, of course, discuss the facts of the case with the parties and may indicate to them the nature of the violations which the staff believes have occurred. The staff should not, however, negotiate a consent or institute discussions relating to consents nor should it indicate the particular recommendation it intends to make to the Commission.

(3) If the Commission authorizes the action the complaint should be filed forthwith.

(4) If the defendants consent to all of the allegations and the relief prayed for in the complaint authorized by the Commission, it will not be necessary to submit the consent to the Commission for its approval. A consent which differs from the complaint should be submitted to the Commission for its approval.

In regard to both administrative proceedings and injunctive actions, the Commission requests that the staff's memoranda to the Commission recommending the particular action set forth separately any arguments or contentions as to either the facts or the law involved in the case which have been advanced by the prospective respondents and which countervail those made by the staff in its memoranda as a basis for the recommendation.

APPENDIX C

UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF COLUMBIA

MDL Docket No. 105

IN RE
NATIONAL STUDENT MARKETING LITIGATION

(Securities and Exchange Commission v. National Student Marketing Corp., et al., Civil Section No. 225-72)

AFFIDAVIT OF LOUIS F. SCHAUER

STATE OF ILLINOIS)
) ss:
COUNTY OF COOK)

LOUIS F. SCHAUER, being first duly sworn, deposes and says:

1. This Affidavit is made in support of a motion by defendants Lord, Bissell & Brook, myself, and Max E. Meyer for leave to amend our Answer to the First Amended Complaint herein.

2. This Affidavit is made to record my recollection of the circumstances surrounding the testimony which I gave before the Securities and Exchange Commission ("SEC") on December 9, 1971 during an investigation being conducted by that agency concerning the National Student Marketing Corporation ("NSMC"). I have prepared this Affidavit on the basis of my best recollection.

3. The only contact which I had with the SEC in regard to the subject matter of the instant litigation prior to the initiation hereof occurred on two occasions. The first occasion was on March 11, 1971, when I accompanied Paul Bschorr, an attorney with White & Case, as counsel to Cameron Brown on the occasion of Mr. Brown's testifying before the SEC during the same investigation. The second occasion was on December 9, 1971 for the purposes of my testimony as more fully described hereinbelow.

4. Throughout the testimony of Cameron Brown, I recall that the atmosphere was friendly and relatively informal. At no time on this occasion were Brown, Bschorr or I advised that any of us were targets of the investigation.

5. Subsequent to Mr. Brown's testimony, I had no contact with or communication from the SEC in conjunction with the matters at issue in this case until December 6, 1971. On that day, which was a Monday, I was telephoned by David Belkin, an SEC staff member, who asked if I could come to Washington to testify in respect of the NSMC matter. He said that the SEC staff was trying to "wrap up the investigation" and would "appreciate" my coming down as quickly as possible. He suggested that December 9, 1971 would be convenient, and that I would be able to fly to Washington in the morning and return to Chicago during the afternoon.

6. Subsequent to my conversation with Mr. Belkin on December 6, I discussed his call with Max E. Meyer, my fellow partner in the law firm of Lord, Bissell & Brook. We agreed that the most helpful thing we could do to assist in this investigation would be to have Mr. Meyer accompany me so that he would be available should the SEC staff have any questions of him, although his presence was not requested by Mr. Belkin.

7. My best recollection is that I telephoned Mr. Belkin during the morning of December 7, 1971 to advise that I would be able to travel to Washington on December 9 and that I would be accompanied by Mr. Meyer. I then offered to bring any materials in the possession of Lord, Bissell & Brook which might be of assistance. Mr. Belkin then stated that he would prepare a subpoena to cover my appearance and the documents and that he would designate 11:00 a.m. as the time at which the testimony would commence.

8. On December 9, 1971, Mr. Meyer and I flew to Washington National Airport on an early morning flight and arrived at the SEC offices shortly after 10:30 a.m. SEC staff members who were present included Belkin and an accountant named Ford (who were among the SEC staff members present at the testimony of Cameron Brown) and several other SEC staff members. During the course of my testimony, additional SEC staff members entered the room and observed. I was shown a copy of the general order by which the investigation was authorized and my best recollection is that no person or entity was named other than NSMC. Although I was advised of my rights under the Fifth Amendment, it was never indicated to me that Lord, Bissell & Brook, Mr. Meyer and I were the objects of investigation nor that there was any consideration being given to our being named defendants. To the contrary, the atmosphere was one of cooperation in an effort to make available all of the facts surrounding the merger closing between NSMC and Interstate.

9. At the close of my testimony, the staff members asked Mr. Meyer whether he would mind answering questions, to which he immediately consented. Mr. Meyer then in effect ratified all that I had said. It was never indicated to Mr. Meyer that he was a target of the investigation.

10. The entire proceeding of December 9, 1971 was cordial and friendly, and when Mr. Meyer and I left the SEC to return to Chicago we had no indication that we were in any way the objects of investigation. On February 3, 1972, I learned that Lord, Bissell & Brook, Mr. Meyer and I had been named in a civil complaint filed by the SEC, and I can only describe the news as a "bombshell". No previous indication had ever been given to us by the SEC staff that our conduct in any way had been the subject of SEC concern.

11. Neither Lord, Bissell & Brook, Mr. Meyer nor I were ever asked to submit our arguments or contentions concerning any activities which are the subject of this action, and none were ever provided by us to the SEC.

Executed this 23rd day of August, 1974.

/s/ Louis F. Schauer
LOUIS F. SCHAUER

Subscribed and sworn to before me
this 23rd day of August, 1974.

/s/ [Illegible]

see

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